

ANNUAL REPORT  
OF THE  
COMMISSION ON STATE TAX AND  
FINANCING POLICY



Indiana Legislative Services Agency  
200 W. Washington Street, Suite 301  
Indianapolis, Indiana 46204

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# COMMISSION ON STATE TAX AND FINANCING POLICY

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## Staff

George Angelone  
Attorney for the Commission

Edward Gohmann  
Attorney for the Commission

Michael Landwer  
Attorney for the Commission

Diane Powers  
Fiscal Analyst for the Commission

James Landers  
Fiscal Analyst for the Commission

Robert Sigalow  
Fiscal Analyst for the Commission

Diana Agidi  
Fiscal Analyst for the Commission

Jessica Harmon  
Fiscal Analyst for the Commission

## **I. STATUTORY AND LEGISLATIVE COUNCIL DIRECTIVES**

The Indiana General Assembly enacted legislation (codified in IC 2-5-3-5) authorizing the Commission to study and investigate any of the following:

- (1) The present state, county, and city tax structure of the state of Indiana.
- (2) Its revenue-producing characteristics and effects upon the economy of the state of Indiana.
- (3) Its equalities and fairness.
- (4) The enforcement policies and administrative practices related to that tax structure.
- (5) The costs of collection in relationship to the burden of the tax.
- (6) Overall administrative matters, fiscal matters, and procedural problems of the various departments of the state, county, and city governments as they relate to tax and financing policy.

The Commission is also authorized to make recommendations to the end that there will be formulated guiding policies that will assure the accomplishment of the following policies:

- (1) Promoting a revenue raising structure in Indiana that will provide adequate revenues to carry on the efficient operation of the state, county, and city governments and at the same time will assure that its burdens will be shared equitably by all taxpayers.
- (2) Encouraging and bringing about the accomplishment of enforcement policies and administrative practices that will result in maximum return from existing taxes to the State of Indiana at a minimum cost to the taxpayers.

The Legislative Council charged the Commission to study the following topics:

- (1) Allocation and distribution of county adjusted gross income taxes (IC 6-3.5-1.1), county option income taxes (IC 6-3.5-6), and county economic development income taxes (IC 6-3.5-7) to civil taxing units within a county, including the allocation of revenues derived from a public safety tax rate imposed under IC 6-3.5-1.1-25 or IC 6-3.5-6-31.
- (2) State and local road funding, including the following:
  - (A) Existing sources of state and local road funding
  - (B) Existing and historical distribution and appropriation levels for state and local road funding.
  - (C) Funding needs for state and local roads.
  - (D) Alternative strategies to replace or supplement the motor carrier fuel tax imposed under IC 6-6-4.1.
  - (E) Alternative funding sources and revenue collection systems, including user and nonuser fees.
  - (F) Strategies to maximize public awareness of the benefits of investments in transportation.
  - (G) Road funding and its effect on economic activity and personal mobility in Indiana.

- (3) Tax credits for contributions to K-12 foundations.
- (4) Dynamic fiscal scoring.
- (5) Fire protection districts and territories, including their funding, services, and costs.

## **II. INTRODUCTION AND REASONS FOR STUDY**

The Legislative Council assigned the study of issues to the Commission that had been requested by a legislator or in a bill or resolution considered in the 2010 session of the General Assembly. The following is a listing of the source of the requests:

- Issue #1: HEA 1086-2010.
- Issue #2: HB 1342-2010 (as introduced).
- Issue #3: Senate Resolution #32-2010.
- Issue #4: Senate Resolution #57-2010.
- Issue #5: Representative Bob Cherry.

## **III. SUMMARY OF WORK PROGRAM**

The Commission met four times in 2010 during the interim between legislative sessions. The meetings were held on August 26, September 20, September 21, and October 21.

In the first meeting, the Commission heard a presentation concerning the concept of dynamic fiscal scoring. The Commission also took testimony concerning tax credits for contributions to Grade K-12 foundations.

In the second meeting, the Commission heard a presentation on the status and history of efforts to establish a Helping Indiana Restart Employment (HIRE) program and a report on road funding. The Commission also took public testimony concerning the organization and taxing powers of fire protection districts and territories and state and local road funding.

In the third meeting, the Commission received a report from the Legislative Services Agency concerning the allocation and distribution of local income taxes among taxing units. The Commission also received public testimony on that subject.

In the fourth meeting, the Commission heard testimony concerning the law governing property tax deductions for wind power devices. The Commission received several property tax reports from the Legislative Services Agency and adopted a final report.

#### **IV. SUMMARY OF TESTIMONY**

The Commission heard testimony from 35 witnesses on the following topics. Additional details concerning the testimony of the witnesses are available in the minutes of the meetings of the Commission. The minutes and all exhibits presented to the Commission can be viewed on the Internet. These materials can be accessed from the legislative home page at [www.in.gov/legislative](http://www.in.gov/legislative)

##### **Allocation and Distribution of Local Income Tax Revenues**

There are three local option income taxes (LOIT): the county adjusted gross income tax (CAGIT), the county option income tax (COIT), and the county economic development income tax (CEDIT). The CAGIT and COIT local option income taxes include three new options permitting a CAGIT or COIT to be imposed or increased: (1) a LOIT rate to freeze property tax levy growth; (2) a LOIT rate for property tax relief; and (3) a LOIT rate for public safety. Ninety-one counties (every county but Lake County) has adopted one or more of the local option income taxes. Annual revenue from these taxes is approximately \$1.3 billion.

The total amount of revenue distributed to a county in a year is determined by the State Budget Agency. Distributions for a calendar year are based on tax returns processed in the state fiscal year that ends in the previous calendar year. For example, calendar year 2011 distributions are based on returns processed in the state fiscal year ending June 30, 2010 (mostly tax returns for the 2009 tax year). The total certified distribution of local option income taxes increased by 3.6% on average from calendar year 2007 to calendar year 2011, but from calendar year 2010 to 2011 the total certified distribution declined by 14.87%.

Generally, distributions to civil taxing units within a county are based on the relative property tax levy imposed by each unit. The CEDIT law permits distributions to be made on relative population. Marion County has a separate statutory distribution formula for COIT. Because of differences in the total amount of property taxes imposed by each civil taxing unit, civil taxing units with similar populations can receive different amounts of local option income tax revenue. Distributions to a civil taxing unit may be more or less than the amount of local option income taxes paid by residents of the civil taxing unit. Witnesses recommended that: (1) more information on local option income tax collections and distributions would be helpful to counties; (2) each county should have its own account for local option income taxes, and the State should provide a monthly report to each county on the balance in the account; (3) municipalities should be authorized to adopt a local option income tax if the county does not adopt such a tax; (4) there should be authority to adopt the local option income tax for public safety, even if none of the other local option income taxes are adopted; (5) if a worker claims a large number of withholding exemptions and never files a return, this should be taken into account when determining distributions; (6) allowing local collection of local option income taxes should be considered; and (7) townships, fire protection territories, and fire protection districts should be eligible for a distribution of the local option income tax for public safety.

## **Deduction for Wind Power Devices**

An issue has been raised as to whether commercial wind power devices are eligible for a property deduction. One company with a wind farm in Benton County has filed a deduction application for the wind power device property tax deduction (IC 6-1.1-12-29). The matter is pending. No other company in Benton County has filed for a similar deduction. There are 495 wind towers in the county. The position of the Department of Local Government Finance is that the wind power device property tax deduction does not apply to wind power devices owned by a utility.

## **Dynamic Fiscal Scoring**

There is a difference between a revenue forecast (a revenue baseline that assumes no change in structure or administration of tax systems) and a revenue estimate or "score" (the impact of changing some component of tax structure). Revenue scoring has three different protocols:

- (1) Static: change in tax has no impact on behavior of businesses or individuals.
- (2) Micro-behavioral dynamic: change in tax alters the behavior of businesses or individuals in markets directly impacted by the tax, but no change in the total economy.
- (3) Macro-dynamic: change in the tax also has a secondary or feedback impact on the state economy as a whole (looking at the impact of the tax on the macroeconomy)

Macro-dynamic scoring requires the development of a state economic model that tracks the initial micro-dynamic effects through the macro economy. The two approaches to macro-dynamic scoring models are: (1) the computable general equilibrium (CGE) model; or (2) the regional economic (REMI) model. Obstacles to using macro-dynamic scoring include: (1) the expense; (2) the short-term horizon for state budgets (the dynamic effects tend to be in the "out" years; (3) the time requirements; (4) unavailable data; and (5) the fact that many assumptions or guesses are necessary.

## **Fire Protection Districts and Territories**

Fire protection districts may be established under IC 36-8-11. Fire protection territories may be established under IC 36-8-19. Either statute may be used to provide fire service in an area that includes more than one township or a combination of townships, cities, and towns. A fire protection district is a political subdivision and imposes a property tax levy that is separate from the property tax levies imposed by the entities creating it. A fire protection territory is not a separate political subdivision and property tax levies are imposed by each of the entities creating the territory to fund the operations of the territory. There are other differences between the two statutes affecting how a district or territory can be organized. Hearing rights and remonstrance rights differ between the two statutes.

Although the property tax levies imposed by the political subdivisions participating in the fire protection territory are subject to the circuit breaker credit caps (IC 6-1.1-20.6), they are not limited by the maximum permissible levy law (IC 6-1.1-18.5-3) in the first three years in which

the political subdivision participates in the territory. However, a change in IC 6-1.1-18.5-10.5 requires the Department of Local Government Finance to approve the proposed levy increases after conducting a hearing in the first year that the political subdivision participates in the fire protection territory.

The creation of fire protection territories in some cases has had the effect of increasing property tax rates in the rural areas of the territories and decreasing or stabilizing tax rates in the urban areas of the territories. Witnesses debated whether the increased taxes were aligned with the cost of the services provided to the rural areas. Witnesses stated that: (1) one public hearing in the establishment process is not enough for the establishment of a fire protection territory, especially given other changes in the law (such as the elimination of the Property Tax Control Board); (2) taxpayers from a participating unit may not have a forum to express their views; (3) taxpayers from unincorporated areas should have a chance to participate in the establishment of tax levies; (4) there are technical issues concerning taxpayer participation; and (5) the provisions in the fire protection district law providing citizens a chance to remonstrate and an opportunity for a hearing before the county commissioners should be replicated in the fire protection territory law.

### **Helping Indiana Restart Employment (HIRE) Program**

IC 22-4.1-17-7 authorized the Commissioner of the Department of Workforce Development to adopt rules under IC 4-22-2 to establish, implement, and maintain the Helping Indiana Restart Employment (HIRE) program for the purpose of increasing employment opportunities for unemployed or underemployed individuals by providing a wage and benefit subsidy to eligible employers that provide to participants an hourly wage and a transferable work skill. IC 12-8-12.5-2 required the Secretary of Family and Social Services to apply to the United States Department of Health and Human Services for maximum reimbursement available to the state from the TANF emergency fund under Division B, Title II, Subtitle B of the federal American Recovery and Reinvestment Act of 2009 for the HIRE program. These provisions were enacted in P.L.110-2010.

Under the program, the State would have reimbursed employers 50% of the wages paid for newly hired eligible employees. The program was scheduled to begin in September 2010, if federal funds became available. Congress did not extend the TANF Emergency Contingency Fund and the HIRE program was not implemented. The Family and Social Services Administration indicated that there is a commitment to implement the program if Congress extends it.

### **Property Tax Reports**

The Commission received the following reports analyzing the impact of property tax policies on tax assessments and taxpayer liability: (1) the 2010 Statewide Property Tax Report; (2) the 2010 Circuit Breaker Total by County Report; (3) the Estimated Circuit Breaker Credits Report; and (4) the Estimated Impact on Net Property Tax Report. The statewide reports were prepared from assessment and tax data collected from the counties.



The average homestead bill declined 2.1% from 2009 to 2010 and declined by more than 33% between 2007 and 2010. Approximately 6.3% of the local tax levy was "lost" to the tax caps. The circuit breaker effect estimate calculated in December 2009 was 1.8% below the actual amount of circuit breaker credits granted. The Distressed Unit Appeals Board actions reduced the impact of the circuit breaker in Lake County. If the Lake County numbers were not included, the estimate was 8.9% below the actual amount. The estimated net circuit breaker credit amounts are \$577 million for 2011 and \$558 million for 2012. These estimated circuit breaker credits are larger than previous estimates, because of lower assessed valuations than expected and large reductions in local option income taxes that would have been used to reduce property taxes.

### **State and Local Road Funding**

The Commission received information describing the sources of state and local road funding and the distribution and appropriation levels for state and local road funding. Funding included stimulus funds received under the American Recovery and Reinvestment Act of 2009.

The Commission received testimony stating that: (1) there is a major backlog in carrying out road repairs; (2) there is a shortfall in county road funding; (3) at least 47 counties have implemented the wheel tax and excise surtax; (4) counties are supplementing highway funding with general fund revenues and (in some counties) with gaming revenues; (5) some bridge needs have become public safety issues; (6) the amount of federal funds available for roads is declining; and (7) local units are participating in procurement pools (e.g., joint salt purchases) to save money. Witnesses recommended that: (1) local units be allowed to use some state funding in place of federal funding, to allow greater flexibility; (2) the cap on the local excise surtax should be raised; (3) referenda should be allowed so that property taxes could be put before the voters; (4) funds should be diverted from the I-69 extension project to other projects; (5) the maximum cost limit imposed on using in-house employees to complete road projects should be raised; (6) the threshold for using quotes rather than bids should be raised; and (7) less money should be diverted to state administration expenses from money available for local road distributions.

### **Tax Credits for Contributions to Grade K-12 Foundations**

SB 288-2010 contained a proposal to provide a state income tax credit to persons and corporations that make a contribution to a public school Grade K-12 foundation. State law already provides a tax credit for donations to an Indiana college or university and for a donation to a scholarship granting organization. The scholarship granting organization tax credit primarily benefits students attending private elementary and high schools that have a tuition charge. Arizona, Idaho, Florida, and Pennsylvania offer state tax credits for donations to public school Grade K-12 foundations.

## **V. COMMITTEE FINDINGS AND RECOMMENDATIONS**

The Commission did not adopt findings of fact or recommendations. The proposed final report

was approved by consent of all five Commission members.

## WITNESS LIST

Brent Auberry, Baker and Daniels,  
representing enXco

Brian Bailey, Commissioner of the  
Department of Local Government Finance

Andrew Berger, Association of Indiana  
Counties

William Boyd

Representative Bob Cherry

Mayor Brad DeReamer, City of Greenfield

Rich Domonkos, Purdue University's Local  
Technical Assistance (LTAP) Program

Tom Hanify, President of the Professional  
Fire Fighters Union of Indiana

Jim Dunham, Family and Social Services  
Administration

Ed Gohmann, Legislative Services Agency

Paige Gregory, CPA, Umbaugh and  
Associates

Jess Gwinn

Katrina Hall, Indiana Farm Bureau

John Halbermann, Purdue University's Local  
Technical Assistance (LTAP) Program

Tom Hanify, President, Professional Fire  
Fighters Union of Indiana

Chris Kiefer of the Indiana Department of  
Transportation

Tom Kouns, Boone County Highway  
Department Supervisor, President of the  
Indiana Association of County Highway  
Engineers and Supervisors

Mike Landwer, Legislative Services Agency

Tim Maloney, Hoosier Environmental  
Council

Jim Mardis, Town Manager, Town of  
Pittsboro

Laurie Maudlin, Build Indiana Council

Leah McGrath, Association Manager of the  
Indiana Association of Public Education  
Foundations

Professor John Mikesell, Chancellor's  
Professor of Public and Environmental  
Affairs, Indiana University-Bloomington

Matt Norris, The Corydon Group,  
representing Indiana Township Association

Kate O'Hare, Hoosier Wind Project, LLC

Tina Peterson, Executive Director,  
Foundation of Monroe County Community  
Schools

Chief James Roberts, City of Greenfield Fire  
Department

Kelly Rose, Benton County Assessor

Adrienne Shields, Family and Social  
Services Administration

Mark Scherer, Beebe, Scherer & Associates,  
LLC, representing Indiana Fire Chiefs  
Association

Brian Short, Indiana Laborers' District  
Council

Bob Sigalow, Legislative Services Agency

Senator Vi Simpson

Barry Wood, Director of the Department of  
Local Government Finance, Assessment  
Division

Gail Zeheralis, Indiana State Teachers  
Association